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Voucher Privatization with Investment Funds

An Institutional Analysis

David Ellerman

The most likely outcome of the strategy of voucher privatization with investment funds may be a two-sided grab fest by fund managers and enterprise managers — along with drift, stagnation, and decapitalization of the privatized industrial sector.

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Summary findings

Common wisdom among post-socialist reformers has been to use voucher investment funds to provide the corporate governance needed to restructure newly privatized enterprises after mass privatization efforts. The idea has been that mass privatization would spread the ownership too wide and make corporate governance difficult.

Ellerman examines the likely institutional behavior of voucher funds and the possible effects of their development on a transition economy. Since most policy advice has been in favor of voucher privatization with investment finds, Ellerman can be seen as playing the devil's advocate, but his argument is institutional, not statistical. Policymaking requires insight and foresight into how institutions will tend to function.

He concludes that voucher funds will introduce a bias in the economy away from the real industrial sector toward an ersatz "financial sector" that will have little if any positive financial role but will be well-protected by friendly regulators.

One long-term consequence of voucher privatization with investment funds, according to this view, is a *de facto* "industrial policy" of real sector decapitalization in favor of short-term rent-seeking by fund managers through board sinecures and lucrative side deals with portfolio companies and through financial market manipulation and paper entrepreneurship in the "financial sector."

Without strong corporate governance from the funds and without stable ownership of their own, many enterprise managers will exploit the post-socialist version of the "separation of ownership and control" to grab what they can in the form of salaries, bonuses, perquisites, and side deals.

The most likely results of the strategy of voucher privatization with investment funds may be a two-sided grab fest by fund managers and enterprise managers — together with the accompanying drift, stagnation, and decapitalization of the privatized industrial sector.

This paper — a product of the Office of the Senior Vice President, Development Economics — is part of a larger effort in the Bank to define policymaking using institutional analysis. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Margaret Murray, room MC4-333, telephone 202-473-6095, fax 202-522-1157, Internet address mmurray@worldbank.org. The author may be contacted at dellerman@worldbank.org. May 1998. (12 pages)

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This work has benefited from many discussions on the topic with Vladimir Kreacic.

Voucher Privatization with Investment Funds: An Institutional Analysis

David Ellerman
World Bank

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Introduction

There has been a rough consensus view of privatization among post-socialist reformers and their western advisors. The stylized story goes something like this.

> Privatize quickly and irreversibly to prevent a comeback of the *nomenklatura.* The quickest and most politically popular technique is mass voucher privatization.[1] However without intermediaries, this would spread the ownership too wide and would thus create the problem of "corporate governance." Therefore voucher privatization needs to be augmented by voucher investment funds to provide the necessary corporate governance for the restructuring of the privatized enterprises.

The purpose of this paper is to consider the likely institutional behavior of the voucher funds and the potential effects of their development on a transitional economy. Since much policy advice has been in favor of voucher privatization with investment funds, this paper could be seen as playing the "devil's advocate" by developing the other side of the argument. The argument will be institutional, not statistical. Policy-making requires institutional foresight—insight into how institutional structures will tend to function.

Why Voucher Investment Funds?

Mutual Funds or Holding Companies?

The main line of the conventional argument is that the investment funds are needed to provide corporate governance for the restructuring of privatized enterprises. But what are the options for a voucher investment fund in a transitional economy? Is it the post-socialist analogue of a mutual fund or a holding company—or is it perhaps some new creation socially engineered especially for the transition?

In a developed market economy such as the United States or United Kingdom where economic institutions have had time to evolve, one finds two extremes, the mutual fund (unit trust in the UK) and the (venture capital) holding company, which have rather opposite institutional logics.

- Mutual funds hold a diversified portfolio of shares with only a small percentage from any given publicly traded company. Mutual funds exercise no direct corporate governance over

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[1] While voucher privatization gives away for free the bulk of the assets on the asset side of the public balance sheet, one needs to consider the liabilities side of the balance sheet which includes:
- funding the daunting pension liabilities and health care needs of the aging population,
- meeting the interest and principal payments of the public and foreign debt,
- funding the social safety net and other economic dislocation costs,
- modernizing the education system to face the new challenges of a competitive market economy,
- paying to clean up after the environmental neglect of the past, and
- rebuilding the infrastructure needed for a modern economy. [see Ellerman, Vahcic, and Petrin 1991]

companies. They are the model of the passive institutional owner that lives by the "Wall Street Rule" of voting with one's feet. Exit is preferred to voice [see Hirschman 1970].

- Holding companies operate in a diametrically opposite way (voice). They hold all or almost all the shares in a portfolio company so that they will reap most of the capital gains from the development and restructuring of the company. They epitomize the active owner that exercises voice rather than exit.

The voucher investment funds have been envisioned by post-socialist reformers as a mixture of mutual funds and holding companies, a chimera with no direct counterpart in an evolved market economy. Western-style legislation restricting any mutual fund's share in a single company (e.g., a 20% maximum) has been enacted in most voucher investment fund regulations as if the funds were mutual funds. But then in the next moment, the voucher funds are described as the vehicles for restructuring the voucherized enterprises as if the funds were holding companies.

There are substantive reasons why the voucher funds will have trouble functioning as mutual funds operate in the West. Most of the shares owned by the voucher funds have no real market. In the West only a small percentage of the companies qualify to be publicly traded and even a smaller percent would qualify in the transitional economies. Yet the voucher privatization programs corporatized medium to large socialist enterprises of most any quality, and issued their shares in return for vouchers. Then the voucher funds have a portfolio full of shares which are essentially illiquid at any significant price ("junk shares").

Can the funds operate as restructuring holding companies rather than as illiquid mutual funds? There seem to be formidable obstacles in the way of the funds operating in that manner. I shall argue that the funds typically lack the economic incentive, power, expertise, and capital to carry out the restructuring function of a holding company.

The Funds' Lack of Incentive for Restructuring

A holding company typically owns all or almost all of its portfolio companies so that it will reap the benefit of all the costs of restructuring the companies. Yet an investment fund might own 20% or 30% at best in a portfolio company. If the fund undertook all the time, effort, and costs of restructuring the company, then 70 to 80% of the capital gains would accrue to the other free-riding shareholders. Thus the fund seems to have little economic motivation for any time-consuming and costly restructuring in light of the regulations restricting a fund's stake in a company. Yet the motivation is much weaker than that. Each fund may have thousands of atomized shareholders (citizens who exchanged their voucher for a share in the fund) so control lies in the hands of the fund management which is typically a separate fund management company. The fee of the fund management company is usually set by the regulations at a fixed percent of the net asset value of the portfolio, not the profits or increase in value of the portfolio.[2] Thus if a fund management company should take steps to increase the value of a portfolio company, only a fraction of the increase accrues to the fund and the fund management company

[2] See Coffee [1996] for these and other typical details of voucher investment funds.

will receive only a small percent of the increase since its fee is a fixed percentage of the total (net) portfolio value [see Box 1].

> Box 1: Lack of Restructuring Incentive
> If a fund owned 30% of a company and the fund management company fee was 3%, then restructuring to increase the value of the portfolio company by $100 would increase the fee by $100 x .30 x .03 = $0.90 or less than one percent of the increase. That is hardly a recipe to incentivize enterprise restructuring. A holding company in the West might receive 90% or more of the value increment due to restructuring a portfolio company, a difference of two orders of magnitude (.90% versus 90%). Observers should not be surprised when fund management companies find more efficient ways to tunnel value out of portfolio companies.

There are other more lucrative ways for the fund management companies to utilize their power without undertaking the difficult job of restructuring. One way is simply by reaping the directors' fees for sitting on the boards of scores of portfolio companies. Another important method of siphoning or tunneling value out of portfolio companies is through special contracts and nontransparent side deals with firms related to the fund management companies. The profits made through these bypass firms need not be shared with the other owners of the portfolio company, not to mention with the citizen-shareholders of the fund.

> Investment funds find the trading of shares, transfer pricing, and nontransparent equity transactions far more lucrative than striving for profits and dividend payments through efficient governance. Indeed, profits and dividends have been an insignificant source of fund income so far. [Hewer 1997, p. 18]

These arrangements not only reduce the incentive to restructure; they may provide a disincentive. Selling a controlling stake to a strategic investor would remove the board sinecures for the fund managers and their friends. And significant restructuring would probably involve exposing and eliminating the special side deals and bypass arrangements for the fund management company.

The Funds' Lack of Leverage for Restructuring

With a small minority of the shares in a company, a fund will usually lack the embedded power to deeply restructure the company. Here again, the investment fund defies the logic of the holding company having all or almost all the shares in a portfolio company. Sometimes coalitions of funds can be formed to exercise more power but the task of restructuring post-socialist enterprises goes far beyond some sporadic changes at the board level. Restructuring by an external agent requires a sustained and single-minded commitment of corporate oversight and intervention.

> Corporate restructuring requires much effort and time, often years of intensive, single-minded concentration of resources. It cannot be imposed successfully from the outside (by shareholders, governments, or the public). It can only be instigated from within by managers able to carry the organization with them. [Wilson 1994, p. 167].

While not impossible, it is rather unlikely for such a restructuring effort to be carried out by a committee of investment funds acting in a coordinated manner. Furthermore, the funds usually have scores of firms in their portfolios so a sustained effort at restructuring a significant number of the firms is rather unlikely.

There is yet another difficulty in the idea of equity funds being the agents of restructuring. The firms in dire need of restructuring are typically candidates for reorganization (if not liquidation) bankruptcy. Yet in the bankruptcy process, control shifts away from equity towards debt—from equity holders to a committee of creditors and a trustee. Thus it is hard to see how equity funds would have the legal leverage for restructuring the seriously distressed businesses in the transitional economies.

The Funds' Lack of Expertise for Restructuring

The post-socialist enterprises typically require serious restructuring so that they will be able to produce profitable products that people will want to buy at prices the people are willing to pay. In spite of the hopes that western firms would become massively involved and would provide funds and the necessary expertise, this has not happened. With a few notable exceptions, the bulk of the post-socialist firms will not be restructured by western strategic investment.

The alternative to direct strategic investment is portfolio investment. There has been some modest western portfolio investment in Central European and Russian investment funds. The Polish mass privatization has tried to design funds to be managed by "western experts" who would restructure the companies in their portfolio. But this approach has not met expectations in view of the large number of firms in each portfolio, the distance of the fund from the day-to-day matters of restructuring a company, and the typical lack of industrial expertise on the part of the fund managers. The investment funds tend to be managed by "professionals" such as financial analysts, lawyers, and accountants who have little or no managerial or technical experience in industry.

The Funds' Lack of Capital for Restructuring

The shares in the funds' portfolios were acquired in a capital-free transaction in return for citizens' vouchers invested in the funds. The capital necessary to start up the funds and the fund management companies is provided by the founders or by loans, and is usually expended on equipment, premises, staff salaries, and advertising. There are usually a large number of funds relative to the size of the market (e.g., more funds than publicly tradable companies in some cases). There were sizable advertising costs to differentiate each fund from the others in the frenzy to attract citizen vouchers. The fund sponsors have to eventually recover the advertising and staff costs from the firms themselves. The firms facing the restructuring costs of the transition could hardly declare enough dividends so that after covering all the costs of the funds (through the management fees) that anything would be left over for dividends to the citizen-shareholders. Soon the citizen-shareholders will get the idea that the value of their "national patrimony" is being siphoned off by this layer of financial intermediaries (which could eventually create a sizable political problem).

The message from the "investment" funds to the portfolio firms is usually "dividends, dividends, and more dividends" so their real impact is likely to be disinvestment. Thus capital for restructuring is probably the last thing that could be expected from voucher investment funds, and the argument that voucher dis-investment funds are important for "capital market development" seems all the more implausible.

Voucher Funds and the Stock Market

Will the voucher funds jump-start the stock market? Expectations in the East about the importance of public stock markets as a net source of funds have been grossly exaggerated. In fact, stock markets in the developed market economies play an rather modest[3] role as a net source of investment finance.

Table 1: Net Sources of Corporate Finance: 1970-1989

	Germany	Japan	U.K.	U.S.
Internal	81	69	97	91
Bank finance	11	31	20	16
Bonds	-1	5	4	17
New equity	1	4	-10	-9
Trade credit	-2	-8	-1	-4
Other 1/	10	0	-8	-13

1/ Capital transfers, other sources, and statistical adjustment.
Source: Corbett and Jenkinson (1994, 11)

One primary purpose of a public capital market is to provide a bridge so that personal savings can flow into the investments of businesses.

> To a large extent equity markets are an interesting and fun sideshow, but they are not at the heart of the action. Relatively little capital is raised in equity markets, even in the United States and the United Kingdom. One cannot expect equity markets to play an important role in raising funds in the newly emerging democracies. [Stiglitz 1994, p. 228]

Furthermore the voucher privatization process does not "jump-start the capital market" since the whole process of distributing vouchers to citizens and firms distributing shares in return for vouchers does not move one ducat of capital from savings into investment. An ersatz "stock market" in a transitional economy for the secondary trading of voucher-based shares does not perform that most basic function of a capital market—in spite of the strong symbolism of the "stock market" in the popular mind.[4] If public stock markets in the West play such a small role

[3] Stock markets can even be a negative net source of funds when dividends and stock buy-backs (perhaps financed by "junk bonds") outweigh new share issues.

[4] This may help explain why the standard western advice ignored non-equity corporate securities in voucher privatization. Why distribute equity as opposed to debt instruments in quasi-bankrupt companies to the citizens when equity has the lowest claim on corporate asset value? Aside from the role of the stock market in popular consciousness in the East and West, the main reason was probably to keep equity control out of the hands of insiders (seen as *nomenklatura*) and, if possible, to distribute it to financial intermediaries seen to be in "reform-oriented" hands.

in net finance and if the stock markets in the TEs don't even have that role, then it is difficult to explain the enormous attention and resources devoted to stock markets in the TEs by western advisors and domestic reformers.

> I think developing and ex-Communist countries should go slow in copying the financial institutions of the United States or the United Kingdom, or of Japan for that matter. When I read that Wall Streeters are visiting Beijing to help the People's Republic establish a stock market, I shudder. It is far from clear that the proliferation of financial instruments, market arbitrage opportunities, and paper transactions in advanced countries has created social product to justify the high-quality human capital resources it devours. [Tobin 1990, p. 233]

The finite western technical and financial assistance would probably be better used in building up a sound banking system and an effective commercial court system—than in promoting disinvestment-oriented "investment funds" and largely symbolic "stock markets."[5]

Can Investment Funds Facilitate Foreign Strategic Investment?

If any western portfolio investors should be so adventuresome as to want to invest in illiquid shares in voucherized enterprises, then the investment funds would surely facilitate that transaction at an appropriate price. But it is doubtful that the investment funds will often be the intermediaries for foreign direct investment. I mentioned above the fund managers' penchant for side deals which would be incompatible with FDI. Another simple reason is that investors will usually prefer asset deals (as opposed to share deals). Usually the voucherized enterprises require substantial restructuring which might involve massive labor shedding and scraping of whole production lines. Rather than buy control of a company in a share deal and have to deal with all the downsizing, a western investor would usually choose to take the opposite approach of only buying the specific assets needed (a "pure play"). The investment will be more like a greenfield investment with some assets drawn from existing enterprises than a takeover transaction on the stock market. There might be some exceptional cases where the foreign investors want control of a brand name or a distribution network and will thus prefer a share deal. But the bulk of the rather small foreign investment will probably take the form of greenfield investments and asset deals, and the investment funds and the public stock markets are irrelevant for those transactions.

[5] The "Wall Street" mentality found in the post-socialist world is reminiscent of the cargo cults that sprung up in the South Pacific area after World War II [see "Cargo Cult Science" in Feynman 1985]. During the War, many of the glories of civilization were brought to primitive people in the southern Pacific by "great birds from Heaven" that landed at the new airbases and refueling stations in the region. After the War, the great birds flew back to Heaven. The people started "cargo cults" to build mock runways and wooden airplanes in an attempt to coax the great birds full of cargo to return from Heaven. Post-communist countries, with hardly a commercial banking system to finance private businesses, have nonetheless opened up "stock exchanges" to supposedly kick-start capitalism. Government officials in East Europe, the FSU, and even Mongolia proudly show the mock stock exchanges, complete with computers screens and "Big Boards," to western delegations (with enthusiastic coverage from the western business press) in the hope that finally the glories of a private enterprise economy will descend upon them from Heaven.

Who Governs the Governors?

Who governs the funds? The relative silence on the question of corporate governance of the funds is all the more peculiar in light of the relative obsession about corporate governance of the voucherized enterprises.

> However, the inherent risk of this approach to solving the governance problem at the enterprise level is the possibility of simply recreating the same problem at the level of the investment funds. In other words, for the investment funds to perform an effective governance role, they must themselves be subject to effective control by their shareholders. [EBRD 1995, p. 136]

Given the power over many firms that might be accumulated in the funds in order for the funds to play the projected corporate governance role (e.g., in the Czech Republic), the question of the governance of the funds should be all the more important.

The individuals running the investment funds are not acting on the basis of their ownership rights in spite of much rhetoric about "private ownership" and "privatization." The funds are institutions that own the shares. The fund managers act as agents for the funds. Indeed the fund managers are employees of separate fund management companies that have management contracts with the funds. The shares in the funds are typically dispersed across a wide swath of the citizenry so there is a separation of ownership and control of the funds for the usual Berle-and-Means reasons.[6] Thus the funds have an even greater "corporate governance" problem than do the corporations whose "corporate governance problem" the funds were supposed to remedy. Effective control falls to the fund management companies that are related to the funds not by ownership but by management contracts.[7]

Consequences of the Investment Fund Strategy

A New Power Stratum?

If the investment fund strategy succeeds in establishing a new institutional power stratum—as it might in the Czech Republic—then one will have a situation reminiscent of the U.S. economy a century ago dominated by the huge trusts and robber barons.

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[6] In some cases, the voucher funds are controlled by banks (e.g., in the Czech Republic) which leads to another set of problems. But my purpose is to review the standard arguments for the funds, and the voucher funds were not sold to the public or to the governments as intermediaries for control of corporations by state-owned or controlled banks.

[7] Why do post-socialist reformers and their advisors consider this sort of corporate governance by non-owning and rather unaccountable agents to be quite acceptable, when at the same time they consider corporate governance through direct and personal ownership by managers and workers to be so unacceptable? One hypothesis is that the fund managers are considered to be acceptable power brokers and professional mandarins (who need no further "corporate governance") while other groups, such as managers and workers, are seen as "unacceptable" power-holders.

> Even though concentrated ownership is desirable from the point of view of incentives, the outcome of Czech privatization may generate political backlash if people realize that an important part of the economy has been given nearly free to a very small number of people. [Roland 1995, p. 39]

Since the public rationale given for the voucher investment funds is so thin and implausible, it may be that the funds have another unspoken rationale. In effect, it could be conjectured that the funds were the conscious or unconscious solution found to the problem of creating an institutional basis for the new economic power-holders. The government could not play that role since industry was to be privatized and the firms were seen as being controlled by the old guard. Thus a new non-state institutional stratum needed to be found for the new post-socialist power elite. In many transitional economies, that turned out to be the voucher investment funds.

In most of the transitional economies with voucher privatization, the funds will probably not obtain the power they have in the Czech Republic. The funds will most likely evolve into rather dysfunctional curiosia of the transition that are neither fish nor fowl by the standards of a normal market economy—neither passive mutual funds operating in a liquid stock market nor Western-style holding companies actively restructuring companies. Their main effect will be to slowly decapitalize the real sector in favor of the financial sector and conspicuous post-socialist consumption. The funds themselves lack the incentive, power, and expertise to take the place of a powerful ownership group to drive enterprise restructuring and development.

The Biased Motivation of Young People

The investment fund strategy may have other subtle and long-term effects on the development of the transitional economies. One effect is on the motivation of young people. In the frenzied get-rich-quick atmosphere of most transitional economies, how many ambitious young people are going to undertake the long and rigorous education program to become computer engineers or biochemists? With only a few years in business school or law school, a young person can perhaps join the "financial entrepreneurs" in the investment funds and get rich quickly through "paper entrepreneurship" without soiling one's hand in the industrial sector.[8]

> [B]anks and investment funds are attracting the best minds of the Czech entrepreneurial class as sophisticated financial deal have become extremely rewarding. In comparison, the second stage of enterprise restructuring--though more needed than ever--is less rewarding, more risky, and requires continuous hard work. [Hewer 1997, p. 19]

This bias in the motivation of the next generation does not bode well for the long-run industrial health of transitional economies (which can hardly compete with New York, London, Frankfurt, Tokyo, and Hong Kong as centers for financial services).

[8]See Dertouzos et al. 1989 or Albert 1993 for treatments of this theme.

Regulatory Capture in the Financial Sector

The attraction of the ersatz financial sector is not restricted to the young people. The existing government administrators and advisors see other people getting rich in the private sector as the result of the government's privatization efforts. When they leave government, they would also like to join in the enrichment process (if they have not already done so behind the scenes). To join a manufacturing firm and work on restructuring for long-term prosperity would simply take too long even if a government official had the relevant technical skills. The financial sector offers the quickest return to people with the right knowledge and connections. This aggravates the short-termism and "grab-what-you-can" mentality inherited from the socialist era.

All this leads to the "regulatory capture" of the existing government privatization administrators by the investment funds and the rest of the financial sector. If one sees one's future as working with certain private organizations, then it is likely that those organizations will receive "special attention" while one is still in government. This leads to laws and regulations that are in the best interests of one's future colleagues (e.g., a fee structure for the fund management companies based on the size of the fund assets regardless of any increase in value) but are not necessarily in the best interests of the country as a whole.

The Bias in the Choice of Firm Structure

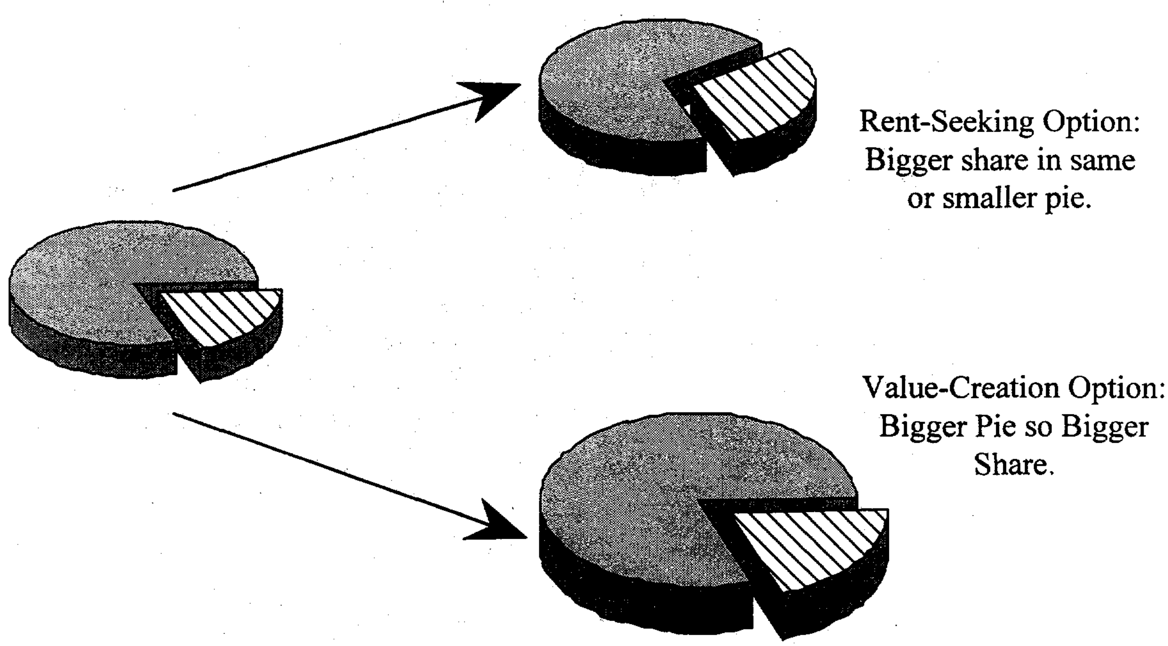
The regulatory capture of the government administrators who see their future in serving finance rather than industry may also have powerful long-run consequences in the determination of firm structure. Each transitional economy faces a fundamental choice of whether to promote Anglo-American-type companies (AA-firms) or what might be called Japanese-style companies (J-firms) [see Blinder 1993]. To oversimplify the question, the AA-firm emphasizes allocative efficiency based on labor and management mobility while the J-firm emphasizes X-efficiency [Leibenstein 1987] based on the immobility of labor and management.

To see the contrast between the opposite strategies, consider the best way to get a ship's captain and crew to keep a ship afloat. One theory is to make it easy for the captain and crew to transfer between ships so that a ship's owner can use marketplace mobility to get the best captain and crew for the job. The opposite theory is to immobilize the captain and crew so they will give their best effort to save the ship rather than jump ship when the going gets rough. If one thinks that the current captain and crew are hopelessly incompetent and that much better replacements can be obtained from elsewhere, then one would favor a system emphasizing mobility. But if one thinks that a ship is probably stuck with the captain and crew it has (particularly when "at sea") and that a better captain ("foreign investor") and crew is not coming in time to save the ship, then one would prefer a system that emphasized immobility and that didn't make it easy to jump ship. The custom of the captain going down with the ship is an example of the "barriers to exit" that lead to the "logic of commitment" of the J-firm in contrast to the "logic of exit" exemplified in the AA-firm [see Kagono and Kobayashi 1994].

The "financial entrepreneurship" of the investment funds depends on the mobility of shares—on their ability to keep the companies and their shares "in play." If the companies had the legal machinery at hand to achieve ownership stability (e.g., obtained with cross-ownership by long-term business partners in Japan or with the trust structure of the American companies owned by their Employee Stock Ownership Plans or ESOPs), then the investment fund strategy would be thwarted. Thus the funds and the sympathetic financial sector regulators will do their utmost to keep the ownership structure of the firms "open" as in the AA-firm. Yet if the outside saviors (e.g., foreign strategic investors) are for the most part not coming, then the logic of mobility is rather pointless and the net effect is to prevent the firms from developing the logic of commitment as exemplified in the J-firm strategy.

Rent-Seeking or Value Creation?

The bias in firm structure is clearly reflected in the choice of managerial strategies. As long as the shares are "in play" and can move around like "marbles on a table top" then managers can seek to increase their wealth by obtaining more shares on the cheap rather than by creating more value in the company. The rent-seeking option is to cheaply get a larger piece of the pie (a constant or decreasing pie) as opposed to the value creation strategy of increasing the size of the pie.



Workers with little or no wage payments (and investments funds desperate for liquidity) are often sources of cheap shares. Managers have various sources of cash including aggressive new banks willing to speculate on getting control of a company. Time horizons are already tragically short in the transitional economies. As long as the rent-seeking option is open to managers, it will be an overwhelming temptation in comparison with medium and long-term value creation strategies. Only when the insider shares are immobilized are the managers forced to create a bigger pie in order to increase the size of their share of the pie. Yet the investment funds and their friendly regulators want to maintain free-floating shares to pursue their own paper entrepreneurship strategies.

The Investment Funds Sector as a Rentier Stratum

The long-run effects go well beyond the bias in the choice of firm structure and the corresponding managerial strategies. In the developing countries, deep-lying economic reforms usually have to dismantle the power of an older rentier class (e.g., a class of large land owners), and the anti-communist revolutions in the TEs were based on dismantling the communist rentier class. The investment fund strategy moves in the opposite direction of creating a new rentier stratum that may function as a long-term burden on the industrial sector. The investment funds did not evolve out of any natural economic process; they provide neither capital nor any relevant expertise to the real sector. They are essentially creations of a politically inspired privatization process. As a rentier stratum, the investment funds extract money out of the productive enterprises but without performing in return any important economic function (that could not otherwise be obtained).

Concluding Remarks

In summary, the voucher funds will introduce a bias in the economy away from the real industrial sector towards an ersatz "financial sector" that will have little if any positive financial role but will be well-protected by friendly regulators. On this view, one long-term consequence of voucher privatization with investment funds is a *de facto* "industrial policy" of real sector decapitalization in favor of short-term rent-seeking by fund managers through board sinecures and lucrative side deals with portfolio companies and through financial market manipulation and paper entrepreneurship in the "financial sector." Without strong corporate governance from the funds and without stable ownership of their own, many enterprise managers will exploit the post-socialist version of the "separation of ownership and control" to grab what they can in the form of salaries, bonuses, perquisites, and side deals. This two-sided grab-fest by fund managers and enterprise managers—together with the accompanying drift, stagnation, and decapitalization of the privatized industrial sector—may be the most likely results of the strategy of voucher privatization with investment funds.[9]

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[9] The focus is on reappraising voucher privatization with investment funds as a strategy for the privatization and restructuring of industry. The effects of the giveaway aspects of voucher privatization on satisfying the looming obligations on the liabilities side of the public balance sheet (see footnote 1) is another topic.

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